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ECONOMIC OUTLOOK

Chamber of Commerce of the United States — April/May 1986

GOOD TIMES AHEAD FOR THE WORLD ECONOMY AND U.S. TRADE

by
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The dollar's fourteen-month slide, lower oil prices, and improvements in economic activity in our major trading partners have finally been reflected in the GNP data. The Department of Commerce preliminary estimates of real economic activity during the first quarter of 1986 show an inflation-adjusted improvement in net exports of $14.8 billion which came about as a result of a significant rise in exports, as well as a drop in imports. During the first quarter, real exports rose by $10.2 billion while real imports declined by $4.6 billion.

The first quarter data also shows that inflation, as measured by the implicit deflator for gross national product, decelerated markedly, from a 3.3 percent growth rate in the fourth quarter of last year to 2.5 percent during the first three months of 1986. As anticipated, lower inflation and interest rates have buoyed consumer sentiment, leading to a $24.4 billion real increase in personal consumption expenditures, compared to an increase of only $0.8 billion in the previous quarter. Continued declines in mortgage interest rates have maintained the level of new housing starts at about two million units, resulting in a 9.7 percent improvement in real residential investment during the first quarter. Also contributing to the first quarter's strength was an inflation-adjusted swing in inventories of $32.3 billion.

The nonresidential investment sector, on the other hand, continues to suffer from uncertainty engendered by the tax reform debate and the initial negative impact of lower oil prices. Significant reductions in investment and employment in the domestic oil and oil-related industries have resulted in a 13.6 percent drop in nonresidential fixed investment and a 0.1 percentage point increase in the civilian unemployment rate during the first quarter of this year.

Despite the weakness in business fixed investment, the first quarter results are a first indication of a strong year ahead. Lower interest rates and prospects of a further deceleration in inflation continue to support a healthy growth path for real consumption. Housing starts will continue to benefit from declining mortgage rates and, as a result, residential investment will remain an important contributor to real GNP growth in 1986. Nonresidential investment, however, will continue weak. The latest Department of Commerce survey of business capital spending plans shows that business expects to increase nominal expenditures for new plant and equipment by only 2.3 percent in 1986 compared to a nine percent rise in 1985. Real plant and equipment expenditures are anticipated to rise by only 0.9 percent in 1986 because of the uncertainty caused by the tax reform legislation before the Congress.

The improvements that we have so far seen in the trade sector are only the beginning. Lower oil prices, inflation and interest rates have so enhanced the outlook for the U.S. as well as the world economy, that international trade will rise substantially in 1986. As a result, foreign demand for U.S. goods will increase. Moreover, the decline in the dollar's value, which is expected to continue through 1987, will enhance the competitiveness of American goods and services in domestic as well as international markets. After years of being a drag on the economy, the trade sector is expected to be a major contributor to domestic growth this year and next.

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Given preliminary estimates of first quarter performance, real GNP is expected to rise by 3.5 percent in 1986 on a year-over-year basis. The stimulus from lower oil prices, lower interest rates, and a declining dollar will gather momentum toward the end of the year, resulting in an increase in real economic activity in the five percent range on a fourth-quarter to fourth-quarter basis.

Factors Affecting U.S. Trade: Foreign Demand

The importance of the foreign sector to economic output in the United States should not be underestimated. Exports and imports have risen significantly as a share of GNP during the past twenty years, from 7.3 percent in 1965 to 15 percent in 1985. Our major trading partners are the industrial nations, which accounted for 63.2 percent of total U.S. exports of manufactures in 1984, up from 53.8 percent as recently as 1981. Similarly, 71 percent of U.S. imports of manufactures came from the developed countries. The bulk of that trade occurs with Canada, Japan and the European Community. Clearly then, improved economic growth in the industrial nations, and with it increased demand for U.S. goods and services, are indispensable if the U.S. trade gap is to be narrowed. The following section discusses the recent performance of our major trading partners and the outlook for 1986.

Economic activity slowed markedly in the industrial nations during 1985, decelerating to a 2.6 percent increase compared to a 4.7 percent improvement in 1984. The bulk of the weakness stemmed from the U.S. performance, although, with the exception of Great Britain, real GNP growth decelerated in all other industrial countries as well. In 1985, inflation in most major countries continued to rise at approximately the same rate as in 1984. The exceptions were France and Italy which enjoyed substantial declines in consumer price increases last year. Unemployment remained high in Europe, averaging 11 percent of the labor force, compared to 7.2 percent in the United States and 2.3 percent in Japan.

The falloff in world oil prices is the major development affecting near term prospects for industrial country growth. Estimates by Morgan Guaranty Trust Company show that a $10 per barrel decline in the price of oil will generate savings of $46.4 billion on the net oil import bill of the major industrial nations (the U.S., Canada, Japan, West Germany, France, the U.K., and Italy). The Morgan Guaranty analysis of the partial impact of this decline in the price of oil shows that this development *alone* will raise 1986 real GNP in the major industrial nations by 0.8 percent of the 1985 level. The study also shows that consumer prices could decline by two percentage points (see Table 1). However, these estimates exclude the effects of changes in exchange rates and government policy which could result from the drop in oil prices, as well as the wealth effects stemming from increases in the value of financial assets and the feedback effects resulting from increased world trade. If these secondary effects were included, the impact on industrial country real GNP would be stronger, and the effect on Canada and the United Kingdom would change from declines in economic activity to improvements.

TABLE 1

IMPACT OF LOWER OIL PRICES[1]

	On Real GNP[2]	On Consumer Prices[3]
United States	0.6	−2.0
Canada	−0.5	−1.6
Japan	1.5	−1.7
West Germany	1.5	−1.9
France	1.4	−1.9
United Kingdom	−1.4	−1.8
Italy	2.3	−1.8
Group Average	0.8	−1.9

(1) Assumes 1986 oil prices average $17 per barrel, down from $27 in 1985.
(2) As a percent of 1985 GNP.
(3) Percentage points.
Source: "World Financial Markets," Morgan Guaranty Trust Company of New York, March 1986.

West Germany

The German economy, already in its fourth year of a modest expansion, seems poised for further improvement. While capacity utilization is close to the 1979-80 peak, the outlook has improved significantly because the economy is close to price stability, in contrast to the accelerating inflation that characterized the situation in 1980. As of February of this year, consumer prices had risen by only 0.7 percent from their year-earlier level. The German labor market, which remained depressed despite improving economic performance, has recently enjoyed a turnaround. But, while new jobs are being created, the unemployment rate, at 9.2 percent in February, is only one-tenth of a percentage point below its year-ago rate.

In 1984 and the first half of 1985, economic activity was supported by rising exports. The net stimulus from foreign demand contributed about one percentage point to the 1985 increase in real GDP. However, domestic demand has been fueling the expansion since mid-1985. In particular, investment in machinery and equipment has enjoyed substantial increases. Consumer sentiment has also improved thanks to higher employment, lower inflation, reductions in the public sector deficit and lower interest rates.

German real GNP during 1986 is anticipated to post a year-over-year gain in the 3.5 percent to four percent range. The increase in economic activity will improve the

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employment picture. The combination of lower oil prices and an appreciating currency will contribute to significantly lower inflation in 1986. On a year-over-year basis, the rise in consumer prices is expected to be below one percent, the lowest rate of inflation since 1954.

France

Lower oil prices have also brightened France's economic prospects, bringing this country's performance more in line with the European average. Estimates of the impact of lower oil prices on the French economy show that this development alone could raise GNP growth by 1.4 percent of the 1985 level. The outcome of the recent French elections, which signaled a shift in economic policy away from state control of the economy toward a strengthening of the free market, greatly improves the economic climate and prospects for future growth.

Industrial production growth, which performed erratically during 1985, showing the weakest recovery performance among the industrial nations, rose by 3.1 percent in January compared to its year-earlier level. Industrial production is expected to strengthen in 1986, rising by 2.5 percent. Although real fixed investment fell by 0.5 percent in 1985, an improvement is expected for 1986. Personal consumption is forecast to rise by 2.5 percent in 1986 thanks in part to tax cuts. As a result, forecasts for real GNP growth this year range from 2.3 percent to three percent, compared to last year's increase of only 1.3 percent. Consumer price increases are anticipated to range between two percent and three percent during 1986 compared to a 5.8 percent increase in 1985.

Italy

Steady economic growth is set to continue in Italy, with the real economy expected to grow by 2.5 percent to three percent, compared to official estimates of a 2.2 percent rate of growth in 1985. In contrast to the other European countries, domestic demand provided the major contribution to 1985 growth. Despite concerns over the country's large budget deficit and the public sector's borrowing requirement, business confidence is improving. Nonresidential investment is the strongest component of total investment while public investment is depressed by budget stringency, and new construction remains weak as a consequence. Personal consumption is anticipated to grow modestly in 1986. Lower oil prices are expected to have a massive impact on the 1986 trade balance. Provisional estimates suggest that a comfortable balance on current account can be anticipated for this year, following a deficit in 1985.

As elsewhere, the decline in oil prices has greatly enhanced prospects for lower inflation in Italy. Although February consumer prices were 7.6 percent above their year earlier level, it is expected that the government's target inflation rate of six percent will be achieved in 1986. As is the case with the other European nations, the expansion, so far, has not resulted in lower rates of unemployment. In fact, the unemployment rate continues to rise, reaching 13.7 percent of the labor force in January compared to 13.1 percent a year earlier. However, major reforms to the *scala mobile*, the Italian wage indexation system, were finalized in December.

Great Britain

The United Kingdom was the only industrial nation enjoying faster economic growth in 1985 than in 1984. Real GDP rose at a relatively strong 3.3 percent rate due, in part, to the end of the miners' strike in March 1985. Although concerns about the impact of lower oil prices on Britain's revenues persist, the recently announced budget has increased optimism about this country's growth prospects. The new budget includes a cut in basic tax rates, and other tax reductions, including the abolition of the gifts tax and tax relief for corporate gifts to charity. Moreover, buoyant nonoil revenues are partially compensating for lower oil revenues, resulting in a reduction in official estimates of the public sector's borrowing requirement for FY 1985/86.

Consumer demand is at a record level in the United Kingdom, rising 3.3 percent during the fourth quarter of last year. As a result of the announced tax cuts, personal consumption is expected to grow faster this year than in 1985. Business confidence remains stable as gross trading profits of industrial and commercial companies rose by almost twenty percent during the first nine months of last year. Government estimates place the increase in investment during 1986 at five percent, a significant improvement over 1985. Housing construction is also showing signs of improvement.

British inflation is expected to decelerate this year. Current estimates anticipate that inflation will increase by four percent in 1986 compared to 6.1 percent in 1985. As elsewhere in Europe, however, the unemployment rate, at 13.3 percent of the labor force, remains high.

Japan

Industrial output in Japan is sagging. Fourth quarter output was down 0.7 percent from the previous quarter, but up 1.2 percent compared to the fourth quarter of 1984. Survey evidence indicates a slowdown in capital investment growth, which some observers estimate will decelerate from a 7.8 percent growth rate in 1985/86 to only 3.8 percent in 1986/87. Investment in the manufacturing sector, which was stagnant last year, is anticipated to decline in 1986. Poor export prospects, owing to the appreciation of the yen, are blamed for this expected outcome. Export growth fell from 18.1 percent in 1984 to 7.8 percent in 1985. Despite the overall slowdown, however,

personal consumption is expected to expand moderately, rising by 2.8 percent in 1986.

The depressing effect of the strong yen on exports has increased pressures for more expansive fiscal and monetary policies to boost domestic demand. In response, the Japanese government is expected to review the tax incentives which keep savings high. The broad measure of the money supply has been posting steady increases (up 8.8 percent in January over its year earlier level). The discount rate, which was cut from five percent to 4.5 percent at the end of January, and to four percent in early March, is expected to be cut again in order to further stimulate domestic demand.

As a result, official government estimates place real GNP growth in 1986 at a relatively strong four percent while private forecasters expect an increase of about 3.5 percent. The appreciation of the yen and lower oil prices have significantly reduced inflation prospects, with some analysts expecting zero inflation in 1986 following a 2.1 percent rise in 1985. Unemployment continues to fluctuate under three percent of the labor force.

Other Factors Affecting U.S. Trade

While we have seen the performance of U.S. exports improve markedly during the past three months, factors other than improved growth in the industrial nations will affect our trade balance. This section summarizes these other factors affecting U.S. trade.

Despite the first quarter improvement in real net exports, the trade deficit remains high. Conventional wisdom lays a large part of the blame for our current trade problems on a *flood* of imports which had a significant negative impact on measured GNP last year. However, as Chart 1 shows, merchandise imports have been on a rising trend since 1975 and recent performance does not suggest a significant deviation from that trend. What is striking about the graphed data is the performance of merchandise exports, which peaked in 1981 and have yet to recover.

Merchandise trade is primarily composed of trade in manufactures, fuels and agricultural products. Although lower oil prices imply a net savings of $16.5 billion on the oil bill of the United States, this only represents 0.4 percent of GNP. Thus, the decline in oil prices, while important, will not be a major contributor to the narrowing of the trade gap. Trade in agricultural products accounts for 17 percent of merchandise exports and eight percent of imports. But despite the slide in the dollar, prospects for this sector are not all that bright.

The international economy is in the midst of structural changes which have shifted comparative advantages among nations and products. In the case of agriculture, these advantages have shifted away from the United States. The $24.7 billion surplus in agricultural goods trade that the U.S. enjoyed in 1981, fell to $8.4 billion (at an annual rate) during the first half of 1985. It is unlikely that the surplus in agricultural trade will return to previous levels, particularly when global food supplies are growing faster than demand. This increase in food supplies stems from factors such as improved technology and infrastructure abroad and increased reliance on market price incentives (particularly in the developing and socialist nations), which are unlikely to be turned around.

Trade in manufactures, which comprises 70 percent of merchandise exports and a similar proportion of merchandise imports, is the key to understanding the U.S. trade gap. Moreover, not only is trade in manufactures the largest component of merchandise trade, it is also responsible for the bulk of the 1980-1985 deterioration in the trade balance (see Chart 2). Thus, a massive swing in manufactures trade is needed to significantly narrow the U.S. trade and current account deficits.

CHART 1
U.S. MERCHANDISE TRADE
($ billions)
1975 to 1985

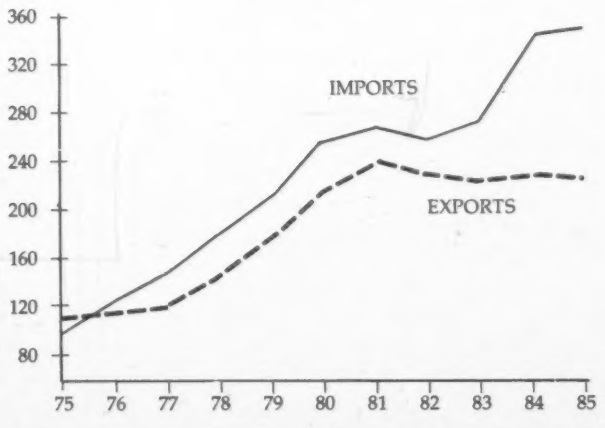
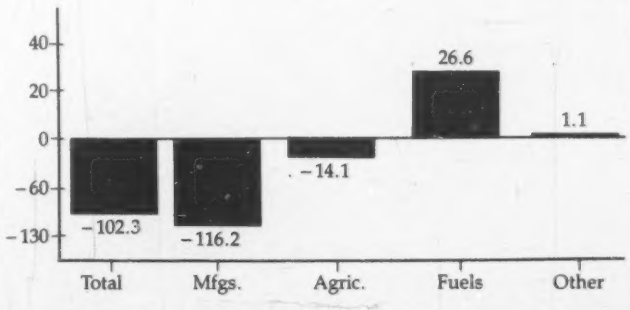


CHART 2
CHANGES IN U.S. MERCHANDISE TRADE
($ billions)
1980 to 1985



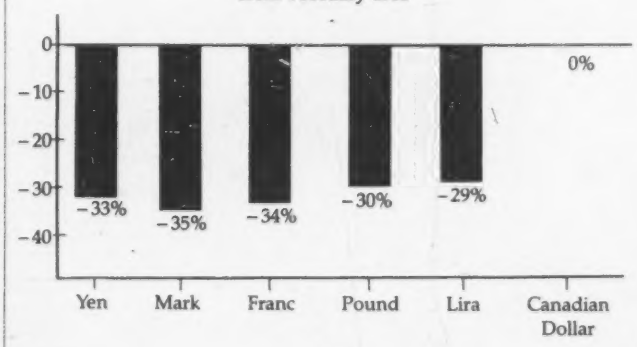
Separating manufacturing trade by key trading partners we find that the debt servicing problems of some developing nations had a significant impact on U.S. trade. Although the developing nations (LDCs) account for only about 30 percent of U.S. manufactures trade, they were responsible for over 40 percent of the deterioration in the balance on manufactures which occurred between 1980 and 1984. Moreover, between 1981 (when the U.S. manufactures trade surplus with the LDCs peaked at $24.9 billion) and 1984 (when that surplus had become a $28.8 billion deficit), the Latin American LDCs accounted for 35 percent of the $53.7 billion deterioration in manufacturing trade with the LDCs. For reasons mentioned in last month's OUTLOOK, while the fall in oil prices has worsened the ability of the indebted oil exporting LDCs to service their debt, it has significantly improved the outlook for the majority of the indebted nations which are net importers of oil. Increased world trade will enhance growth in the LDCs as well as in the industrial West. Although a surge in LDC imports is not expected, indeed it would not be desirable, it is expected that improved economic activity in these nations will, in the least, stem the deterioration of our trade balance with this group of countries.

But while trade with the LDCs should not be overlooked, our most important trading partners are the industrialized nations of Western Europe and the Pacific Basin. The bulk of the $104.5 billion 1985 deficit in U.S. manufactures trade is accounted for by trade with Japan, the newly industrializing countries (NICs) of East Asia, the European Community and Canada. In 1984, almost 55 percent of U.S. manufactures exports were destined for Canada, Japan and the EEC, while 64.9 percent of our manufactures imports came from those areas.

The depreciation of the dollar plays a major role in the trade adjustments now underway. As Chart 3 shows, the dollar's slide from its peak in February of last year, *vis-à-vis* the currencies of the major industrial countries has been substantial. This adjustment in our currency with respect to that of our major trading partners will continue to improve the U.S. trade balance. Nevertheless, there are certain factors which, for the moment, mitigate the impact of the dollar's decline on exports and imports. The dollar's decline (24 percent on a real effective basis), although substantial, was from a historically high peak and it has yet to reach the levels which prevailed in 1980 when the trade deficit was of a more modest size (see Chart 4). More importantly, however, the value of the U.S. currency has not yet deteriorated with respect to the currencies of the Latin American nations, the Asian NICs and Canada, which together account for 43.3 percent of U.S. imports of manufactures.

CHART 3

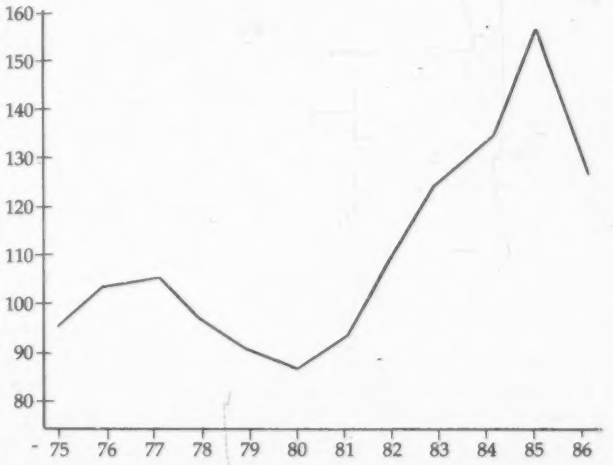
PERCENT CHANGE IN DOLLAR EXCHANGE RATES
from February 1985



Source: See Table 1.

CHART 4

EXCHANGE VALUE OF THE DOLLAR
(trade weighted index)



As Chart 3 shows, the U.S. dollar has not declined at all against the currency of our most important trading partner: Canada. Our northern neighbor was the destination for 25.6 percent of U.S. exports of manufactured products, and the source of 20.2 percent of U.S. manufactures imports in 1984. Moreover, the U.S. dollar has continued to appreciate in relation to the currencies of many developing countries. For instance, between September 1985 and March 1986, the dollar appreciated by 48 percent against the Brazilian cruzeiro; and it has not changed against the Korean won, which is pegged to the dollar. In fact, most LDCs and NICs peg their currencies either to the dollar or to a basket of currencies in which the dollar has the largest weight. As a result, there has been no significant dollar depreciation against these countries' currencies. This implies that while our trade deficit with Japan and Europe will indeed decline, the impact on our trade balance may be less than expected as imports of, for example, Japanese goods are substituted by imports of, say, Korean goods.

Other factors, independent of oil prices or the decline in the dollar's value, also affect the American balance of trade. Foreign exporters have used the past five years of

TABLE I
UNITED STATES ECONOMIC OUTLOOK 1986-1987
Prepared by the U.S. Chamber of Commerce
(Percent change from previous period at seasonally adjusted annual rates.)

	QUARTERS										YEARS		
	Actual			Forecast							Actual	Forecast	
	85:3	85:4	86:1	86:2	86:3	86:4	87:1	87:2	87:3	87:4	1985	1986	1987
GROSS NATIONAL PRODUCT													
Real GNP	3.0	0.7	3.2	4.9	5.0	7.1	6.1	4.1	4.0	3.8	2.2	3.5	5.3
Consumption	4.6	0.1	4.3	4.5	4.4	4.7	3.8	2.4	2.5	2.3	3.3	3.5	3.6
Residential Investment	8.5	5.7	9.7	11.5	0.1	2.3	2.2	-2.0	-3.9	-3.9	1.7	7.2	0.5
Nonresidential Investment	2.4	11.3	-13.6	8.4	8.0	14.5	11.1	7.9	9.5	7.8	9.7	2.8	10.1
Equipment	3.0	13.5	-17.8	10.9	9.8	17.0	11.7	7.4	9.7	7.4	8.8	3.0	11.0
Structures	1.2	7.2	-5.1	4.0	4.9	10.0	9.9	8.9	9.1	8.5	11.4	2.4	8.6
Exports	-5.1	6.6	11.9	13.0	16.1	21.5	14.8	12.8	11.6	10.8	-3.0	8.4	15.0
Real Net Exports	-119.8	-140.8	-126.0	-114.4	-100.0	-83.7	-74.4	-64.4	-54.1	-43.4	-108.4	-106.0	-59.1
Imports	12.8	24.5	-3.6	-0.1	0.1	2.8	4.3	2.5	1.6	1.0	2.7	6.0	2.3
Government Purchases	37.3	23.4	-32.2	-6.3	-2.3	0.0	0.3	0.0	-0.2	-0.2	10.3	-3.3	-0.7
Final Sales	5.0	1.3	-0.4	5.3	5.3	7.0	5.2	3.7	3.8	3.5	3.9	2.9	5.0
Change in Business Inventories (82$B)	-1.8	-6.3	26.0	22.8	20.7	22.0	30.5	35.1	37.2	40.1	5.7	22.9	35.7
Industrial Production	3.1	2.0	2.5	8.3	8.3	13.0	10.6	6.6	6.7	6.4	2.6	4.9	9.1
Total New Car Sales (mill.)	12.4	10.3	11.0	11.3	11.5	11.7	12.1	12.0	11.7	11.7	11.2	11.4	11.9
Domestic Car Sales (mill.)	9.4	7.0	7.9	8.3	8.6	8.9	9.1	8.8	8.7	8.6	8.3	8.4	8.8
New Housing Starts (mill.)	1.69	1.77	1.99	1.95	1.96	2.00	1.99	1.93	1.92	1.89	1.74	1.98	1.93
EMPLOYMENT, WAGES AND PRICES													
Civilian Unemployment Rate (%)	7.2	7.0	7.1	7.0	6.8	6.4	6.1	5.9	5.8	5.6	7.2	6.8	5.9
Compensation	3.0	3.2	5.9	2.7	2.8	2.8	3.9	3.4	3.7	3.8	3.7	3.7	3.3
Productivity	0.4	-3.4	1.7	2.8	2.4	3.7	2.4	1.3	1.5	1.4	-0.1	0.9	2.3
Unit Labor Costs	2.6	6.9	4.1	-0.1	0.3	-0.9	1.4	2.0	2.1	2.4	3.8	2.8	1.0
Consumer Price Index	2.4	4.4	1.5	-1.3	1.8	1.8	2.3	2.6	2.9	3.0	3.5	2.0	2.1
Implicit GNP Deflator	2.9	3.3	2.5	1.9	2.4	2.1	2.4	2.9	3.0	3.1	3.3	2.6	2.5
Prime Interest Rate (%)	9.5	9.5	9.4	8.5	7.9	7.6	7.4	7.4	7.6	7.6	9.9	8.4	7.5
3-mos. Treasury Bill Rate (%)	7.1	7.2	7.0	5.5	5.0	4.8	5.1	5.2	5.5	5.5	7.5	5.6	5.3
Corporate Bond Rate (%)	11.0	10.6	9.6	8.5	8.3	8.1	8.1	8.3	8.4	8.4	11.4	8.6	8.3
Real Personal Disposable Income	-4.6	2.4	5.7	2.9	2.2	3.2	3.8	1.6	1.6	1.0	1.4	3.5	2.0
Profits from Current Production ($B)[1]	221.7	218.8	230.9	234.9	246.8	266.6	275.3	286.3	296.9	306.4	211.2	244.9	291.2
GOVERNMENT FISCAL POLICY ($B)[2]													
Unified Receipts											736	793	862
Unified Outlays											937	990	1015
Unified Deficit											-201	-197	-153

[1]After-tax corporate profits with inventory valuation and capital consumption adjustments.

[2]Unified budget figures on a fiscal year basis.

SOURCE: U.S. Chamber of Commerce, Forecast Section, using the Washington University model of the U.S. economy.

FORECAST ASSUMPTIONS

The April/May forecast assumes that spending cuts along the lines of the Gramm-Rudman-Hollings Act's requirement are enacted in FY 1986 and FY 1987. However, the cuts fall short of the Gramm-Rudman-Hollings deficit reduction goals. Tax increases or reform are not anticipated. The nation's money supply (M1) is assumed to grow by 8.3 percent in 1986 and 7.2 percent during 1987. The trade weighted exchange value of the dollar falls by 14 percent during 1986 and 4.5 percent in 1987. The price of imported oil averages $18.75 per barrel in 1986 and $14.00 in 1987. The federal minimum wage is not expected to increase.

dollar appreciation to increase their penetration of U.S. markets, an endeavor which required substantial investments. It is unlikely that they will easily give up these market shares, particularly if sales in the U.S. remain profitable. Moreover, many U.S. firms, importers as well as multinationals, have entered into long-term contracts with foreign suppliers that will not be quickly revised. And finally, some U.S. firms may actually mitigate the competitive advantage that the dollar depreciation affords them by raising their own prices in an attempt to increase profit margins. This ill-advised strategy runs against known economic relationships. In the least, it prevents them from reaping the full benefit of the currency realignments now underway and may even prevent some firms from increasing their domestic market shares.

Conclusion

What policy actions are necessary to correct the imbalance in world trade and reduce the U.S. trade deficit? The Morgan Guaranty study mentioned above shows that a significant reduction in the U.S. current account deficit can best be achieved through industrial country cooperation. The scenario that the analysis envisages includes (1) an increase in annual economic growth in Japan and Western Europe which averages only 0.6 percent higher than anticipated under current fiscal and monetary policies, and (2) a further depreciation in the value of the dollar. If this were to occur, their simulation shows that the U.S. current account deficit would be halved by 1990. More importantly, this would be accomplished without increased inflation in the United States, as could occur if we were to rely only on dollar depreciation to reduce the trade deficit, or a U.S. recession which would reduce the deficit by curtailing U.S. import demand. The enactment of fiscal policies that would result in such an outcome would not only be beneficial to the United States, but to the world economy as a whole since the major industrial nations would be growing more rapidly.

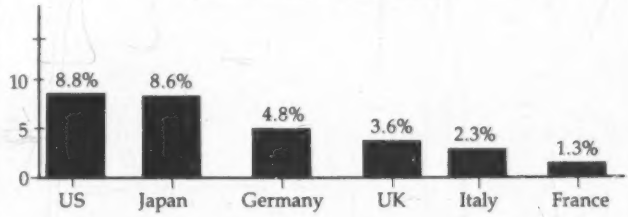
More stimulative fiscal policies are clearly needed in our major industrial trading partners. A recent report from Germany's Kiel Institute notes that although lower oil prices and interest rates will contribute to higher growth this year, this expected outcome does not result from "fundamental changes in conditions [which strengthen] economic dynamics." In fact, the report notes that "fiscal policies have hardly been reformed, leaving tax ratios high."

As noted in previous issues of the OUTLOOK (see the October 1984 issue, tax rates in Europe remain significantly higher than in the United States. As a result, the recovery in industrial production has not been as rapid in these countries as in the United States. Chart 5 shows increases in industrial production in the U.S., Japan, and the major European economies since the end of the recession. The graph clearly shows that the European economies have lagged behind the United States and Japan and that there is much room for improvement. The timing could not be more propitious, since the appreciation of the European currencies and the yen with respect to the dollar, and the decline in oil prices have significantly reduced the likelihood of increased inflationary pressures even in the face of increased domestic stimulus in these countries. The outlook for such policy changes in our major trading partners is good. In fact, some of these nations have already announced their intentions to reduce taxes.

CHART 5

INCREASE IN INDUSTRIAL PRODUCTION

(percent change, 82:4 to 85:2)



Source: Federal Reserve Bank of St. Louis.

This month's outlook assumes that proposals to increase domestic stimulus in our major trading partners are enacted. The value of the dollar is assumed to continue to decline during the next two years, but at a more moderate pace than during the past 14 months. Although it is now very difficult to predict the path of oil prices, for purposes of the forecast we have assumed that they average $18.75 per barrel in 1986 and stabilize at $14 per barrel in 1987. As a result, real net exports are expected to improve markedly. The deficit on real net exports declines from $108 billion in 1985 to $59 billion in 1987.

PROTECTIONIST PRESSURES CONTINUE TO RISE

by
Rajni Bonnie Ohri

As the previous article demonstrates, the decline in the dollar's value has begun to improve the international price competitiveness of U.S. exports, thereby reversing the trend toward ever larger trade deficits. Nevertheless, pressures for the enactment of restrictive trade measures have recently intensified. Calls for increased government intervention in international trade are now common, ranging from pleas for isolated policies to cope with the problems of specific groups, to proposals for comprehensive programs to manage trade. Formulating international trade policy is difficult in such an atmosphere.

Protectionist bills have been introduced in the Congress in large numbers during the past year. Among the most important factors contributing to this increase in protectionism are the large number of workers and industries affected by international trade, recent macroeconomic performance, and the belief that other countries are engaging in unfair trade practices. As this article shows, the case for protectionism is a misleading basis for policy.

Increased Dependence on Trade

The volume of world trade in goods grew nine percent in 1984, one of its fastest ever rates of growth. But this rate of growth is not expected to last. Between 1950 and 1973, each one percent rise in world income was accompanied by a 1.6 percent rise in world trade. Between 1973 and 1984, it was accompanied by only a 1.1 percent increase. In other words, the responsiveness of world trade to income has fallen by nearly a third since the 1960s. And in 1985, world trade slowed dramatically, growing by less than three percent.

One reason for the concern over the rise in protectionist sentiment is that the United States is becoming more dependent on world trade. From 1960 to 1984, the ratio of imports to GNP rose from 4.6 percent to 11.8 percent while the share of exports to GNP increased from 5.7 percent to 10.2 percent. These trends were a part of a rising global interdependence as virtually all countries are engaging more intensively in trade.

An implication of this growing international orientation is the increase in the proportion of the U.S. labor force that depends on international trade for employment and income. Specifically, the proportion of manufacturing employment facing import competition rose from 8.4 percent in 1970 to 14.7 percent in 1980, and the proportion of manufacturing employment directly related to exports rose from 8.1 percent to 14.5 percent. Other productive factors also have an increasing stake in foreign trade. During the same period, the import-related share of manufacturing value increased from 8.3 percent to 14.4 percent, and the export-related share increased from 8.5 percent to 15.1 percent. Moreover, increasing trade has had a disproportionate impact on certain sectors of the economy. The effects have been concentrated in the tradeable goods sectors—those industries that export a sizeable portion of their output, industries that compete with imports, and their suppliers. Thus, many of the recent calls for protection stem largely from long-run losses in international competitiveness due to shifts in comparative advantage. While such shifts benefit the economy by allocating resources to more productive uses, they can be difficult and costly in the short-run. Protectionist pressures arise to forestall these costs.

Industries that have lost their comparative advantage have suffered from increasing trade. Growing disadvantages have occurred in footwear, apparel and textiles, basic iron and steel, and motor vehicles. The growing trade deficits in these sectors largely reflect shifts in comparative advantage to other countries. Production techniques in these industries have become fairly standardized, with the result that these goods can be produced by relatively unskilled workers. Over time, the higher productivity of U.S. workers producing these goods has disappeared, and high domestic wages have made U.S. costs uncompetitive. For example, operating under the price umbrella of quotas, the steel industry pays wages 31 percent higher than the U.S. average and 23 percent higher than the average manufacturing wage. Capital, therefore, has moved to countries with relatively lower wages.

As a result, in 1984, imports claimed a significant portion of the U.S. market for the following products: nonrubber footwear (49.8 percent), apparel (20.2 percent), steel (16.7 percent). Although most major categories of American industry face import penetration ratios of 20 percent or less, a majority of them have experienced an increase in the proportion of domestic demand satisfied by foreign producers. Moreover, in important categories within the broad industry classifications, imports account for a major share of the domestic market. For instance, the ratio of imports in the machine tools industry is 31 percent, even though for the nonelectrical machinery industry as a whole, it only reaches 14 percent. At the same time, however, two industries in which foreign producers have made significant inroads into domestic markets—basic chemicals and television and radio sets—have not experienced further increases in the import penetration ratio since 1981.

Indeed, competitive pressures have forced U.S. industries to lower production costs and increase productivity and innovation, thus becoming more efficient. This would not have occurred behind protective barriers. And, closing our markets to foreign goods would boomerang against us even under the unlikely event that foreigners do not retaliate. As U.S. demand for imports declines, so would U.S. exports, since foreign countries, faced with a shrinking export market, would experience declines in economic activity and concomitant reductions in their demand for imports, including U.S. products.

Some industrial sectors have benefited substantially from increased international trade. Interestingly, the industries within manufacturing that have had the highest growth rate of employment since 1980 have several factors in common: an increased worldwide demand for their products, little if any protection, lower than average manufacturing wages, and typically increased import penetration into their markets. Electronics and computers are two examples.

Macroeconomic Factors

Another reason for resurgent protectionism is the effect

that economic conditions have on employment. Many argue that in order to "save American jobs" imports must be restricted. The belief is that higher trade barriers will promote domestic employment by substituting domestic production for imports without restricting export-related employment through foreign retaliation. Indeed, protection may save jobs in import-competing industries, but this is likely to be matched by the less visible loss of jobs elsewhere in the economy.

While some observers claim that each additional billion dollars worth of imports costs 25,000 to 30,000 jobs, the U.S. has nonetheless created over 9 million new jobs over the past three years, a period during which the trade deficit exploded to record levels. Thus, the expansion of imports has not come at the expense of aggregate employment in the United States. Such a record stands in contrast to those of the other developed countries, many of which are running trade surpluses but have continued to experience job losses.

Much of the recent protectionist pressure is undoubtedly related to high unemployment in 1981 and 1982 and to subsequent macroeconomic events. Widespread unemployment increased protectionist sentiment across an array of industries and intensified pressures for import relief in the steel, textile and automobile industries. Moreover, the recession was accompanied by a rapid appreciation of the dollar, which induced more stagnation in the tradeable goods sectors than in the general economy.

The ensuing recovery has not moderated protectionist pressures because the dollar continued to appreciate until last year and, by many standards, it is still considered too high. While the full impact of the dollar decline is not expected to be felt for some time, several industry groups and individual companies claim that they have experienced increases in foreign orders, as American goods and services become less expensive abroad. Indeed, according to the American Paper Institute, exports of wood pulp to Western Europe and Japan were up 49 percent in January and February of this year from the same period in 1985. They attributed this improvement to the dollar's slide. The David R. Webb Company of Indiana claims that their export orders for lumber were up 80 percent this year due to the lower value of the dollar. Some companies with overseas subsidiaries such as Deere & Company, are already benefiting as their profits from foreign units are worth more when translated into dollars, adding to their overall profitability at home.

American consumers, who for several years have enjoyed inexpensive imports, will soon see an increase in the dollar value of imported goods. Japanese products, in particular, are bearing higher prices because of the yen's surge against the dollar. With foreign currencies rising, all types of imports, including televisions, motorcycles, beer and personal computers, are likely to become more expensive. In April, Nissan raised its prices on new cars and trucks by an average of 3 percent; this followed a 4 percent increase as recently as December. Volkswagen, Volvo, Toyota and Honda have also raised prices on new cars and further increases are expected. Matsushita Electric Corportion of America is already planning a new round of price increases after one round took effect in January. And Sony and Sanyo are also planning further price hikes that will range up to 15 percent on selected items. But most of the price increases have yet to come, partly because suppliers are tied into contracts that bear fixed prices and because of the lag in putting price increases into effect.

Unfair Trade Practices

Still another reason for rising protectionist sentiment is the view that other countries are not fair in promoting their exports and restricting their imports. Those holding this view advocate specific protectionist threats to force other countries to remove or forestall their trade restrictions. For many, the idea of free trade has been replaced by the idea of "fair trade" which would make the government responsible for forcing other countries to provide a level playing field.

Much of the impetus for protectionist actions stems from frustration over the U.S. trade deficit with Japan. Some observers accept this deficit of nearly $50 billion in 1985 as evidence that the Japanese market is closed to U.S. products such as telecommunications equipment and other high-tech goods. Elsewhere, the United States is currently involved in a spate of trade disputes with Canada, including flaps over alleged provincial subsidies to Canadian lumber producers and restrictions on cattle and hog imports. In addition, the Administration is threatening to place quotas on imports from the EEC in retaliation for actions that could jeopardize $1 billion in U.S. farm sales to Spain and Portugal. Trade frictions have intensified between the U.S. and Western Europe over a variety of products that include agriculture, steel, telecommunications and passenger airplanes.

As a result, the U.S. is now taking a harder line on trade policies in other ways as well. For example, the U.S. is revising its policy of Generalized System of Preferences toward the richer less developed countries. One possible revision would require these foreign governments to make concessions in order to retain their duty free access to U.S. markets. Legislation is also pending to provide for the automatic erection of trade barriers when imports reach a certain market share. A revision of the Escape Clause of the Trade Act is under consideration to provide lower interest loans to increase the ability of foreigners to buy U.S. products.

Congress also insists on domestic content restrictions and "buy American" provisions in public and private con-

tracts. The 1982 gas tax act specified that, in federally funded construction projects, cement must be 100 percent American-made unless that raises the cost by more than 25 percent. In addition, the United States is involved in promoting agricultural exports through programs of blended credits designed to offset similar subsidies by the EEC.

Professor Gary Haufbauer estimates that the percentage of U.S. imports covered by protection has risen to 21 percent in 1985 from eight percent in 1975. The trend toward protectionism has accelerated in the last five years, largely due to the dollar's steep rise in value. The strong dollar, combined with the powerful economic recovery, encouraged a flood of imports and increased domestic industries' demand for protection. Although the Reagan Administration claims to be vigorously opposed to trade barriers, it has found it politically impossible to fully resist these pressures.

Costs of Protectionism

The costs to society of erecting trade barriers outweigh the benefits to individual groups because restricting trade causes substantial economic inefficiency. The costs are the higher prices domestic consumers must pay for goods shielded from foreign competition. These higher prices are, in effect, hidden taxes. Part of the hidden tax is distributed to domestic workers and firms that produce the protected goods in the form of higher profits, wages and employment. Some of the tax, however, is dissipated in lower economic efficiency, which benefits no one. It is a particularly regressive tax, because the increased prices, particularly for consumer goods, fall most heavily on lower income Americans who spend a greater percentage of their income on these products. Empirical estimates show that recent U.S. trade barriers have indeed been an inefficient means of increasing the incomes of workers in the tradeable goods sectors. These estimates reveal that eliminating the trade barriers and directly compensating workers in the affected industries for their lost income would be much less expensive than limiting imports.

Clothing tariffs and quotas provide a dramatic example of the high costs of U.S. protectionism. The United States has a tariff averaging 26 percent of the value of all clothing imports. According to a study by the Federal Reserve Bank of New York, which conservatively assumes that trade barriers do not raise the price of domestically manufactured clothes, consumers pay a tax as high as $12 billion a year to protect the U.S. textile industry. A more comprehensive measurement, according to Professor Haufbauer, puts the figure at $27 billion, or $42,000 for every job saved.

Other imported products that are protected by U.S. trade barriers are:

Steel: The U.S. signed a quota agreement with the EEC in October 1982 limiting steel imports. At the same time, Japan initiated a system of "voluntary" steel export restraint to avoid more direct U.S. trade action. These measures substantially reduced European and Japanese steel shipments to the United States but shipments from developing countries soared in their place. In September 1984, the United States began negotiating more "voluntary" export restraints with other steel suppliers designed to limit total steel imports. The Federal Reserve Bank of New York conservatively estimates that these restraints cost consumers about $2 billion a year.

Book Manufacturing: The U.S. book printing industry is largely shielded from foreign competition. To be eligible for U.S. copyright protection, virtually all books and periodicals sold in this country must also be printed and bound here. That restriction costs consumers an estimated $500 million each year.

Ceramic tiles: Makers of ceramic floor and wall tiles are protected by tariffs that average 25 percent of the import value. The cost to consumers is about $116 million a year.

Peanuts: To prevent imports from undermining its peanut price support program, the government has kept a strict quota on imported peanuts since 1953. The approximate annual cost to the consumer is $170 million.

Rubber Shoes: The U.S. rubber footwear industry is shielded by high tariffs that in some cases have changed little since the 1930s. The cost to consumers is over $230 million a year.

Autos: Under a "voluntary" agreement, Japan began restricting auto exports to the United States in April 1981. As a result, according to the New York Fed, Japanese car prices rose over $2,000 and cost consumers an estimated $4.5 billion in 1984. Quotas on automobiles alone have increased the cost of imported cars by $1,400, and the price of domestic cars by over $600. Brookings Institution economist Robert Crandall estimates that with 1984 sales of nearly eight million U.S. cars, the quotas took $3.2 billion out of the pockets of consumers.

Conclusion

The primary objective of trade policy should be to keep world markets open to international specialization and exchange. The benefits of free trade far outweigh the advantages that narrow sectors gain through protectionism. Government management of trade through protectionism will not solve problems that result from international macroeconomic imbalances.

Undoubtedly, there are some very real problems. Some industries are losing their ability to compete in the world market, causing great hardship to many workers. Some exporters are facing insurmountable barriers to the export

of their goods and services. But protectionism is not the answer. Indeed, it would worsen the very problems it promises to fix. Its costs in higher prices, reduced trade opportunities, the stifling of innovation, and the threatened when an alternative set of policies is put into effect: policies that will create new jobs, increase our comed when an alternative set of policies are put into effect: policies that will create new jobs, increase our competitiveness here and abroad, and raise the general standard of living.

TANKS OR TOASTERS

by
Richard W. Rahn

Whether you capitalists like it or not, history is on our side, we will bury you.
Nikita Khrushchev—1957

Far from burying the United States and other capitalist economies, it has become increasingly clearer that the forces of history are running against the Soviets rather than with them. Soviet economic growth is now down to a crawl.

During the first fifteen years following Khrushchev's prediction, it was indeed true that Soviet economic growth was relatively faster than ours, albeit from a lower base. In 1960, Soviet GNP (Gross National Product) was approximately 49 percent of U.S. GNP. By 1975, it had reached a high water mark of 58 percent of U.S. output. Since then, however, Soviet economic growth has slowed down relative to U.S. growth, and by 1985, it had fallen to approximately 53 percent of the U.S. level. Moreover, in per capita terms, Soviet GNP growth has been even weaker than ours. Both the United States and the Soviet Union experienced a slowdown in GNP growth during the 1970s and early 1980s. But, the slowdown in U.S.S.R. economic activity was more severe than ours, and while U.S. growth has bounced back sharply since 1983, Soviet per capita GNP growth continues on a downward path. Now if present trends continue, and there is every reason to believe that they will, by the end of this century, or a mere fifteen years from now, the Soviet economy will be smaller in relation to the U.S. economy than it was at the time of Khrushchev's famous boast.

Growth prospects in the United States, Southeast Asia and most of Western Europe are projected to improve significantly over the next two years, in large part due to falling oil prices. As was discussed in last month's ECONOMIC OUTLOOK, every $10 per barrel drop in the price of oil is expected to increase U.S. real GNP by 0.8 percent during the first year and 1.6 percent during the second year over the baseline projection. For the Soviets, however, the effect of lower oil prices is just the opposite. Until recently, approximately 70 percent of the U.S.S.R.'s hard currency earnings came from trade in petroleum, petroleum products, and natural gas. As a result, the Soviets can expect to lose 20 percent to 40 percent of their hard currency earnings this year due to the drop in the price of oil that has already occurred.

Many analysts believe that the Soviets would not have achieved even the meager growth rates of recent years without the importation of substantial amounts of Western machinery and technology. Thus, a fall in hard currency reserves not offset by additional international borrowing will force them to cut back on both the legal and illegal acquisition of Western machinery and technology. In addition, it will become increasingly more difficult for the U.S.S.R. to provide economic and military aid to their client states.

Despite the obvious immorality of the position, the communists have historically justified the oppression of the citizenry and denial of basic human rights as necessary to improve the overall standard of living. Recent Soviet economic performance demonstrates the hollowness of such justification. Perhaps the most telling indictment of the Soviet system is the fact that, among the industrialized nations, only in the U.S.S.R. is life expectancy falling and infant mortality increasing. It is now estimated that the average Soviet man can expect to live to about sixty years of age, compared to his American counterpart who will live, on average, to be seventy-two years old.

The actual hardship faced by the typical Soviet citizen is far more severe than the gross economic statistics indicate. For instance, military spending and gross investment as a proportion of Soviet GNP are three times as much as in the United States. Hence, personal consumption is far lower. In fact, a number of our most able analysts of the Soviet economic system believe that as much as 40 percent of Soviet GNP is spent for military purposes either directly or indirectly. At first glance, such an assertion might seem to be a gross exaggeration. However, even a cursory examination of Soviet production statistics makes it look plausible. For example, the Soviet Union consumes approximately 50 percent more steel per year than the United States, but relatively little goes into the production of automobiles, trucks, consumer appliances, or road, bridge, housing, and commercial construction. Where, then, does it go if not for military production? In 1985, the Soviet Union produced 45 percent more tanks and armored fighting vehicles than all of the NATO countries combined. But surprisingly, there were only 10,000 toasters manufactured for a population of 278 million.

Clearly, it is very difficult to compare Soviet economic statistics with ours, particularly since the Soviet pricing

system is not based on supply and demand. By necessity, the U.S.S.R. uses prices prevailing in the West as reference points. In fact, the Soviet system could not function without these market price reference points since they would have no idea of the relative value of things, and without knowing relative values, it is impossible to make rational resource allocation or pricing decisions. As it is, many Soviet prices and labor rates are largely meaningless. What after all, is the real opportunity cost of Gulag labor? To compare relative standards of living, economists use such measures as the number of hours the typical person must work to buy a pair of shoes or an automobile. But if for most people, the product is not available or if when available is of such poor quality that it does not work properly, how meaningful is a relatively low price? Despite such measurement problems, it is clear from real output and consumption data, that the Soviet economy is seriously faltering relative to the capitalist nations.

If the Soviet leadership cared to improve the standard of living for the average citizen, they would have to either cut back on the portion of GNP which goes into military expenditures or reorganize economic policies to achieve better resource allocation and provide incentives for productive activities. This can only be achieved by decentralizing the decision-making process and hastening the privatization of major sectors of the Soviet economy. These alternatives, by necessity, would reduce the power of the central authorities. Yet given their past behavior it is unlikely they would consent to such a change. Thus, the average Soviet citizen can only look forward to either a stagnant or falling standard of living.

TABLE 1

COMPARATIVE ECONOMIC STATISTICS UNITED STATES VS. THE SOVIET UNION

	U.S.	U.S.S.R.
Per Capita GNP (1985)	$16,320	$7,442
Real per Capita GNP[a]		
1961–1975	2.3%	3.5%
1976–1982	2.1	1.7
1983–1985	3.2	1.6
Grain Production (kil/capita)[b]	1,330	620
Meat Production (kil/capita)[b]	105	61
Steel Production (million metric tons)[b]	84	154
Newsprint Production (million metric tons)[b]	5.0	1.6
Energy Consumption (bbl of oil/capita)[b]	54	33
Auto Registration (units/thousand persons)[b]	535	25
Life expectancy (men)[c]	72	60

(a) average annual growth rates.
(b) 1984 data.
(c) 1985 data in years.
Sources: U.S. Department of Commerce, C.I.A., *The Economist.*

DOES THE VALUE-ADDED TAX CONTRIBUTE TO INCREASED GOVERNMENT SPENDING AND TAXATION?

by
*Terree Alverson**

Proposals for tax increases have, once again, surfaced in Congress. This time they are being offered as a solution to the federal budget deficit problem, as a way to achieve revenue-neutrality in the tax reform process, and as a way to achieve the Gramm-Rudman deficit targets. One of the proposals under consideration is a form of the value-added tax (VAT), a method of raising revenues currently used in most European countries. This year, a value-added tax was included in the Superfund reauthorization program which has not yet passed the Congress, and a VAT-type tax, called the Business Transfer Tax (Senator Roth, Republican–Delaware), was introduced in the Senate as part of an overall tax reform program.

No other recent tax increase proposal elicits such vehement opposition (or support) as the value-added tax. Opponents argue that the addition of a VAT to our revenue system will increase the overall level of taxation and will stimulate greater federal government spending. They contend that because the VAT is basically a hidden tax, the rate is easier to raise, making it possible to increase government spending without the public's knowledge or permission. Even if the VAT is introduced as a replacement for other taxes, opponents suggest that increases in the rate will soon result in an increase in overall taxation. They point to the European experience and assert that VAT rates have risen steadily since their inception, as has federal government spending, which in Europe, has consistently been a larger percentage of output than in the United States.

Supporters of the VAT contend that it is not significantly different from other taxes, and deny the assertion that it has contributed to higher taxes or increased government spending in Europe. They claim that, because it is a broad-based consumption tax and does not bias the tax code against savings, it is more equitable than the current U.S. corporate income tax. If revenues are eventually deemed necessary to reduce chronic U.S. budget deficits, then the VAT is touted by its supporters as the best method, since it provides the least interference in the economy.

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Two recent papers, representing opposing viewpoints, have been circulated throughout the business community. The first paper, *Value-Added Taxes and the Size of Government: Some Evidence*, by J.A. Stockfisch, argues that VATs do not contribute significantly to increased government spending. The opposing viewpoint is detailed in *VAT and Small Business in North America*, a paper by Graham Bannock and Partners, Ltd. commissioned by the small business community. This report notes that non-VAT countries have historically enjoyed lower tax rates than VAT countries.

Both reports have methodological flaws which render their findings questionable. The Stockfisch report compares total taxes to the rate of growth in gross domestic product (GDP) in VAT and non-VAT countries and concludes that the relative size of government grew in some of the VAT *and* non-VAT countries. However, although the author excludes social security taxes, he does not separate VAT revenues from other taxes collected by the federal government. As a result, it is impossible to ascertain what proportion of total taxes are sales taxes, corporate income taxes, or VATs and how those proportions change over time. It is, therefore, difficult to conclude from this study whether or not the VAT was responsible for increased spending in those countries where spending grew. Moreover, the Stockfisch study ignores the fact that governments borrow heavily, and that they have engaged in deficit spending on an ever-increasing basis. To examine receipts alone in determining increased government spending does not take the complete picture into account.

The Bannock paper samples only one year (1983) in its comparison of low-tax non-VAT countries and high-tax VAT countries. Clearly, this is a fatal flaw. Too many macroeconomic factors, such as recession, may affect revenues over a short period of time, thus skewing the results. To get a complete picture, one must examine a longer period of time, and include both pre-VAT and post-VAT years, to track the average tax burden of each country.

TABLE 1

THE GOVERNMENT SECTOR IN VAT COUNTRIES
1965–1982

	Average Annual Growth in Outlays as a % of GDP	Average Annual Growth in Receipts as a % of GDP	Average Annual Deficit as a % of GDP
Austria	.74	.49	−1.38
Belgium	1.41	.87	−4.29
Denmark	1.82	1.15	−0.62
France	.73	.51	−1.18
Germany	.75	.58	−2.27
U.K.	.66	.60	−3.50
Ireland	1.25	.69	−6.96
Italy	1.21	.69	−7.36
Netherlands	1.46	1.08	−2.60
Norway	.85	.94	+3.12
Sweden	1.79	1.14	+0.58
Group Average	1.15	.79	−2.41

Source: Tax Policy Section, U.S. Chamber of Commerce.

TABLE 2

THE GOVERNMENT SECTOR IN NON-VAT COUNTRIES
1965–1982

	Average Annual Growth in Outlays as a % of GDP	Average Annual Growth in Receipts as a % of GDP	Average Annual Deficit as a % of GDP
Australia	.64	.43	+ .24
Canada	.99	.68	−2.11
Finland	.54	.40	+1.79
Greece	1.00	.45	+1.57
Iceland	.40	.45	+ .56
Japan	1.26	.76	−3.03
Portugal	1.40	.79	−1.74
Spain[a]	1.00	.67	−1.04
Switzerland	.61	.59	+3.95
U.S.	.58	.33	−2.57
Turkey	.24	.90	+1.04
Group Average	.79	.59	−1.34

(a) Added a 12% VAT on January 1, 1986.
Source: Tax Policy Section, U.S. Chamber of Commerce.

Comparison of VAT and Non-VAT Countries

This article seeks to shed some new light on the issue of the value-added tax by examining the available data in greater detail and correcting some of the shortcomings of the Bannock and Stockfisch reports. Tables 1 and 2 show the rate of growth in the ratios of outlays and receipts to GDP in VAT and non-VAT countries between 1965 and 1982. The evidence shows that these two ratios grew more rapidly in VAT countries than in non-VAT countries. Outlays rose 46 percent faster in VAT countries than in non-VAT countries, while receipts rose 34 percent faster.

Table 3 separates the time period into pre-VAT and post-VAT years, and shows during which period each country ran a deficit or surplus. Interestingly, the data shows that even before the introduction of the VAT, the rate of growth in outlays in the VAT countries was 38 percent higher than in the non-VAT countries. After the inception of the value-added tax, this rate rises to 1.29 percent of GDP, an increase of 18 percent over the previous period. Six out of the eleven countries studied (Austria, Belgium, France, Ireland, Italy, and the United Kingdom) had post-VAT increases in the average annual growth rate in budget outlays as a percentage of GDP. The rate of growth in revenues falls by 21 percent after the enactment of the VAT. Seven out of the eleven countries (Belgium, Denmark, Germany, Ireland, Norway, Sweden, and the Netherlands) showed a post-VAT decline in average annual growth in receipts as a percentage of GDP.

TABLE 3

THE GOVERNMENT SECTOR BEFORE AND AFTER THE IMPOSITION OF THE VAT

VAT Countries	Years	Average Annual Growth in Outlays as a % of GDP	Average Annual Growth in Receipts as a % of GDP	Average Deficit/ Surplus as a % of GDP
Austria	65–72	0.29	0.40	−0.01
	73–82	1.01	0.53	−2.50
Belgium	65–70	0.84	0.90	−3.56
	71–82	1.65	0.89	−5.63
Denmark	65–66	1.80	2.30	+1.56
	67–82	1.70	1.11	−0.81
France	65–67	0.30	−0.10	−0.30
	68–82	0.75	0.59	−1.36
Germany	65–67	1.00	0.60	−1.20
	68–82	0.74	0.54	−2.39
Ireland	65–71	1.23	1.40	−4.53
	72–81	1.76	0.62	−9.10
Italy	65–72	0.61	0.11	−4.34
	73–82	1.90	1.28	−9.78
Netherlands	65–68	1.73	1.70	−1.58
	69–82	1.48	0.96	−2.83
Norway	65–69	1.42	1.63	+3.36
	70–82	0.64	0.77	+3.03
Sweden	65–68	2.23	2.00	+2.95
	69–82	1.80	0.95	−0.10
U.K.	65–72	0.53	0.51	−1.35
	73–82	0.73	0.81	−5.22
Group Average	Pre-VAT	1.09	1.04	–
	Post-VAT	1.29	0.82	–

Source: Tax Policy Section, U.S. Chamber of Commerce.

Similarly, the VAT countries, on average, experienced larger deficits. The ratio of deficits to GDP was 2.41 percent in the VAT countries compared to 1.34 percent in the non-VAT countries. The data does not support the claim that a VAT will help reduce a country's budget deficit. Only two of the eleven VAT countries enjoyed surplus revenues as a percentage of GDP in their post-VAT period. The United Kingdom went from pre-VAT budget deficit to a post-VAT surplus, and Norway had surpluses in both periods. More importantly, however, seven out of the eleven nations studied (Belgium, Austria, Ireland, France, Germany, Italy, and the Netherlands) had pre-VAT surpluses and post-VAT deficits.

Table 4 shows that between 1965 and 1982 the ratio of total taxes to GDP rose more rapidly in the non-VAT countries. In 1965, taxes as a share of GDP in the VAT countries were 35 percent. By 1982, the ratio had risen by 11.2 percentage points to 46.2 percent. In the non-VAT countries, however, that ratio rose from 21.1 percent in 1965 to 37.1 percent in 1982, an increase of 16 percentage points. Although it is not possible to tell from the data why taxation in the VAT countries grew at a slower pace, it should be noted that the ratio of total taxation to GDP remains considerably higher in the VAT countries than in the non-VAT, even in the period prior to enactment of the VAT.

TABLE 4

TOTAL TAXES AS A SHARE OF GDP

Year	VAT Countries	Non-VAT Countries	Percentage Point Difference
1965	35.0%	21.1%	13.9
1973	36.1	28.3	7.8
1982	46.2	37.1	9.1
Increase*	11.2	16.0	–

*Percentage point difference 1965 to 1982.
Source: Tax Policy Section, U.S. Chamber of Commerce.

Tables 5 and 6 show the percentage of total taxation accounted for by the corporate income tax. Only three of the eleven VAT countries—France, Ireland, and Austria—experienced declines in the ratio of corporate taxes to total taxes between 1972 and 1982. Three other VAT countries—Italy, the Netherlands, and Norway—experienced increases in corporate taxation while VAT taxes as a share of total taxes fell.

This data, however, cannot be used as proof to the argument that the institution of VATs results in lower corporate taxation. Table 6 shows that six of the nine non-VAT countries for which there is data also enjoyed declines in the share of corporate income taxes in total taxation. Some advocates of the VAT argue that it can be used as a replacement tax which would allow the reduction of the corporate income tax, while maintaining rev-

TABLE 5

CORPORATE INCOME AND VALUE-ADDED TAX RECEIPTS AS A PERCENT OF TOTAL TAXATION

VAT Countries	Corporate Income Tax	Corporate Rate	Value Added Tax	VAT Rate
Austria	1973 3.4% 1982 2.9	55%	1973 19.0% 1982 20.0	20.0%
Belgium	1972 7.2 1982 6.1	45	1972 18.7 1982 16.7	19.0
Denmark	1972 2.2 1982 2.6	40	1972 18.0 1982 22.0	22.0
France	1972 5.7 1982 5.1	50	1965 20.0 1982 20.9	18.6
Germany	1972 4.8 1982 5.1	36	1972 16.4 1982 16.4	13.0
Ireland	1972 5.6 1982 4.7	50	1972 4.6 1982 19.4	23.0
Italy	1973 7.1 1982 8.0	46	1972 15.0 1982 14.1	8.0
Netherlands	1972 6.7 1982 6.8	43	1972 15.8 1982 15.0	19.0
Norway	1972 2.5 1982 16.5	51	1972 22.0 1982 18.0	20.0
Sweden	1972 4.0 1982 3.3	32	1972 14.0 1982 13.0	19.0
U.K.	1972 7.5 1982 9.6	52	1973 3.8 1982 13.4	15.0

Source: Tax Policy Section, U.S. Chamber of Commerce.

TABLE 6

CORPORATE INCOME TAX RECEIPTS AS A PERCENT OF TOTAL TAXATION (Non-VAT Countries)

Non-VAT Countries	Year	Corporate Income Tax	Corporate Rate
Australia	1972	15.2%	46%
	1982	9.9	
Canada	1972	11.1	51
	1982	8.0	
Finland	1972	4.5	43
	1982	4.5	
Greece	1972	3.9	48
	1982	4.0	
Iceland	–	N/A	N/A
	–	N/A	
Japan	1972	22.7	42
	1982	19.7	
Portugal	–	N/A	40
	–	N/A	
Spain	1972	7.7	35
	1982	4.6	
Switzerland	1972	7.8	10
	1982	6.2	
Turkey	1972	5.0	40
	1982	12.8	
U.S.	1972	11.2	46
	1982	7.0	

Source: Tax Policy Section, U.S. Chamber of Commerce.

enue neutrality. Although this report does not delve into the reasons behind the adoption of the VAT, the high rate of corporate income taxes in the VAT countries would indicate that the VAT was not adopted as a replacement tax. The average corporate income tax in the VAT countries is 45.5 percent, compared to 40.1 percent in the non-VAT countries (see Tables 5 and 6).

Conclusion

There does not appear to be a clear-cut case supporting the argument that a VAT tax will contribute to increased spending and taxation. But it does appear that many of the VAT countries have higher spending and tax levels as a percentage of GDP than the non-VAT countries. Moreover, most of the VAT countries had high tax and spending levels prior to the imposition of the VAT.

The enactment of a VAT clearly does not solve a nation's deficit problems. Eight of the eleven VAT countries ran pre-VAT deficits, and the deficit increased, as a percentage of GDP, after the enactment of the VAT. Moreover, two surplus countries (Sweden and Denmark) experienced post-VAT deficits. Only five out of eleven non-VAT countries (Canada, Japan, Portugal, Spain, and the United States) ran deficits during the period 1965-1982.

Many economists make the argument that the use of a VAT as a replacement for part or all of the corporate income tax is more efficient economically because it taxes

consumption instead of savings. However, this is difficult to prove with the European VATs since they were add-on taxes. In those cases, corporate income taxes were not reduced, consequently, GDP growth did not change significantly.

Based on the data presented here, the case is inconclusive on whether to adopt a VAT. Other factors, such as administrative, compliance, and start-up costs raise the cost of implementation. Adding those costs onto the fact that VAT countries do have somewhat larger government spending and receipts than non-VAT countries, it would appear that, in most cases, the country that chooses a VAT might be getting more of a loser than a winner.

TRENDS IN COMMERCE
NOTES ON TABLE II
MAY 1986

by
*Martin Lefkowitz**

Gross National Product (GNP)–The preliminary estimate of Gross National Product–the total value of goods and services produced–shows that the inflation-adjusted growth rate for the first quarter was at an annual 3.2 percent rate, more than four times the growth rate for the fourth quarter of 1985. Consumer spending, which had dragged down the fourth quarter performance, rebounded in the first quarter to a 4.3 percent growth rate, while businesses started accumulating inventories. However, a lower rate of fixed investment was reported in the first quarter as a result of cutbacks in the energy industry. Real exports also showed a substantial increase while imports declined.

The Services Sector–Employment in service sector establishments jumped 271,000 in March and is now 2.8 million above its year-ago level. This compares with an increase of 102,000 jobs in the goods-producing sector over the last year. Over 96 percent of the job growth in the economy during the past year has been in services industries. However, the Department of Labor may be overstating the decline of jobs in the goods producing sector of the economy as more firms are contracting-out for services that were previously performed by their own workers.

Consumer purchases of services jumped 1.1 percent in February while consumers cut back on goods purchases. Major domestic airlines reported that revenue passenger miles flown, that is, the number of passengers multiplied by the miles flown by each passenger, reached 18.9 billion in February, an increase of 12.6 percent from its year-ago level. For the first two months of 1986, domestic passenger traffic on U.S. scheduled airlines was up 11.3 percent from the same period a year ago.

Money Supply–The nation's money supply–as measured by M-1, currency in circulation plus demand deposits–increased by 1.1 percent during March. Money supply growth has slowed to a 7.4 percent annual rate in the latest three-month period, but is still 11.5 percent above its year-ago level, and remains considerably above the Fed's target range of three to eight percent.

Employment–The civilian unemployment rate slipped one-tenth of a percentage point in March to 7.2 percent, compared to 7.3 percent in February. The number of non-agricultural payroll jobs–as measured by the monthly survey of business establishments–increased by 190,000 in March. Civilian employment–as measured by the monthly survey of households–was virtually unchanged in March at 108.8 million after seasonal adjustment.

Prices–The Consumer Price Index for all urban consumers (CPI-U) fell 0.4 percent in March for the second month in a row, the largest two-month drop in more than 36 years. For the first three months of the year, consumer prices fell at an annual rate of 1.9 percent, the best quarterly performance since 1954. Much of the decline was attributed to a record 12 percent fall in gasoline prices, more than double the 5.9 percent February drop. Food prices, which fell a sharp 0.6 percent in February, edged upward by 0.1 percent in March. With oil prices continuing to drop sharply, experts predict that the April index should show a similar decline at the retail level.

Wholesale prices of finished goods decreased 1.1 percent from February to March. For the first three months of this year, the index has fallen at an annual rate of 12.4 percent, the largest decline since 1947. The major contributing factor was a 21.9 percent plunge in wholesale gasoline prices. Food prices rose 0.3 percent, the first increase this year, following a 1.6 percent decline in February.

Crude goods prices fell 2.8 percent in March, following a 5.0 percent decline in February. Intermediate goods prices fell 1.2 percent, following a 1.4 percent fall in February. All major categories of crude goods are now significantly below their 1985 levels, except for construction materials.

Housing Starts– Privately owned housing units were started at a seasonally adjusted annual rate of 1,949,000 in March, a decrease of 2.4 percent from the February level. However, at 1.99 million units, total starts during

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TABLE II
TRENDS IN COMMERCE

	Current Period		Previous Period	Year Ago	Percent Change From Previous Period	Percent Change From Year Ago
Population (Millions) [a]	Feb/86	240.7	240.6	238.1	0.0	1.0
Gross National Product ($B)	I/86	4,116.7	4,059.3	3,917.5	1.4	5.1
Gross National Product (82$B)	I/86	3,619.2	3,590.8	3,547.8	0.8	2.0
Money Supply (M1) ($B)	Mar/86	638.2	631.0	572.2	1.1	11.5
PEOPLE AND THEIR MONEY						
Personal Consumption Expenditures ($B)	Mar/86	2,680.8	2,671.5	2,530.2	0.3	5.2
Personal Consumption Expenditures (82$B)	Feb/86	2,357.5	2,337.3	2,297.3	0.9	2.2
Disposable Personal Income ($B)	Mar/86	2,903.6	2,896.2	2,725.1	0.3	6.6
Disposable Personal Income (82$)	Feb/86	2,555.8	2,533.0	2,487.1	0.9	2.8
Personal Savings Rate (%)	Mar/86	4.2	4.3	4.0	−0.1[b]	−0.7[b]
Civilian Employment (millions)	Mar/86	108.8	108.6	107.0	0.1[c]	1.6[c]
Civilian Unemployment Rate (%)	Mar/86	7.2	7.3	7.3	−0.1[b]	−0.1[b]
Average Hourly Earnings	Mar/86	$8.74	$8.71	$8.52	0.3	2.6
Consumer Price Index (All Urban, 67=100) [a]	Mar/86	326.0	327.5	318.7	−0.4	2.3
Purchasing Power of the Dollar (67=$1.00) [a]	Feb/86	0.309	0.308	0.315	0.3	−3.1
Prime Interest Rate (%) April 22, 1986		8.5	9.0	10.5	0.5[b]	−2.0[b]
Retail Sales (B$)	Mar/86	116.6	117.5	111.9	−0.7	4.2
SERVICES SECTOR						
Employment in Services (Millions)	Mar/86	74.7	74.4	71.9	0.4	1.4
Consumer Purchases of Service ($B)	Feb/86	1,375.0	1,358.7	1,283.7	1.1	7.1
Consumer Purchases of Service (82$B)	Jan/86	1,136.6	1,144.8	1,112.9	−0.7	2.1
Domestic Revenue Passenger Mileage Flown - Major Airlines (Billions) [a]	Feb/86	18.9	19.8	16.8	−6.2	12.6
BUSINESS PROFITS AND OUTPUT						
Corporate Profits and Cash Flow ($B) [a]						
Before Tax [a]	IV/85	238.8	228.6	228.0	2.3	2.5
Profits Tax Liability	IV/85	87.1	87.4	87.4	−0.3	−0.3
Tax Liability as a Percent of Profits	IV/85	37.3	38.2	38.3	−0.9[b]	−1.0[b]
After Tax [a]	IV/85	149.5	141.1	140.6	6.0	6.3
Net Cash Flow	IV/85	415.8	404.0	371.6	2.9	11.9
Industrial Production (77=100)	Mar/86	125.1	125.7	124.0	−0.5	0.9
Capacity Utilization Rate (Mfg.) (%)	Mar/86	79.9	80.5	80.4	−0.6[b]	−0.5[b]
New Housing Starts (thou. units)	Mar/86	1,949.0	1,997.0	1,849.0	−2.4	5.4
BUSINESS COSTS						
Unit Labor Costs (nonfarm) (77=100)	IV/85	170.5	167.8	163.9	1.6	4.0
Unit Nonlabor Costs (nonfarm) (77=100)	IV/85	158.0	161.4	158.4	−2.1	−0.3
Producer Price Indices (67=100) [d]						
Crude Materials	Feb/86	290.5	301.3	318.9	−5.0	−5.5
Intermediate Goods	Feb/86	317.2	318.8	319.5	−0.4	−0.7
Finished Goods	Feb/86	296.2	297.2	292.1	−0.7	1.4
FEDERAL SPENDING AND DEBT						
Federal Spending Index (67=100)	Feb/86	586.5	616.7	584.5	−4.9	0.3
Federal Government Debt Outstanding ($B) [a]	Jan/86	1,966.8	1,950.3	1,684.4	0.8	16.8
INTERNATIONAL TRADE						
Exports of Goods & Services ($B)	I/86	378.4	367.8	379.6	2.9	−0.3
Imports of Goods & Services ($B)	I/86	473.6	481.2	421.9	1.6	12.3
Balance on Goods & Services ($B)	I/86	−95.1	−113.4	−42.3	16.1	124.8
WHAT'S AHEAD?						
Index of Leading Indicators (67=100) [a]	Feb/86	175.4	174.1	167.4	0.7	−4.7

NOTE: All data seasonally adjusted unless otherwise noted

[a] Not seasonally adjusted

[b] Percentage point difference

[c] January data is a new series that is not comparable to previous data

[d] Index number not seasonally adjusted, percent change seasonally adjusted

the first quarter were at their highest level since 1978. Building permits, an indicator of future activity in the home building industry, were 2.4 percent for the month.

Corporate Cash Flow and Profits—Corporate profits have been sluggish for the past year. Profits increased by 2.5 percent between the fourth quarter of 1984 and the fourth quarter of 1985, slower than the rate of inflation, indicating that profit margins are falling. However, corporate cash flow, which includes depreciation allowances, has increased nearly 12 percent over that same period, indicating a strong cash position in the corporate sector.

Industrial Production—Industrial production decreased by 0.5 percent in March, following an 0.7 percent drop in February. The February drop in output was the largest setback in the industrial sector since the recovery began in December, 1982. The industries responsible for the decline were oil drilling, autos and steel whereas the defense and space industry reported an 0.6 percent increase during March, following two months of declines.

The capacity utilization rate in manufacturing decreased to 79.4 percent in March from 80 percent in February. The decline was attributable to a significant drop in auto production. The operating rate for that industry fell from 85.1 percent in February to 75.7 percent in March.

Productivity—Nonfarm business productivity fell 0.2 percent during 1985, the first annual decline since the recession. Business output rose 2.7 percent while hours worked increased 2.8 percent for the year as a whole. Manufacturing productivity rose 2.7 percent in 1985 and output for the manufacturing sector rose by 2.5 percent, while hours worked were down by 0.2 percent.

Interest Rates—The prime interest rate fell to 8.5 percent on April 21, 2.0 percentage points below the rate prevailing at this time last year. The lowering of the prime rate followed a cut in the discount rate by the Federal Reserve from seven percent to 6.5 percent. The prime lending rate is now at the lowest it has been since August 1978. Three- and six-month Treasury bill rates were both below the six percent range on April 22, and thirty-year Treasury bond rates dropped to 7.15 percent, also the lowest level in over eight years.

Federal Spending—The "Federal Spending Index," a U.S. Chamber devised measure of the monthly change in federal expenditures, increased by 0.3 percent in February compared to its year-ago level. Federal receipts for the first five months of the fiscal year 1986 increased by 5.7 percent, while expenditures for the same period rose by 6.3 percent. The federal deficit for the first five months of fiscal year 1986 was $107.7 billion compared to $99.6 billion during the same period in fiscal year 1985.

Personal Savings—The personal savings rate was 4.2 percent of after-tax income in March, about the same as in the previous month and a little higher than the 4.0 percent reported in March of last year. The low rate of personal savings has been attributed to a number of factors, including the rising stock market that has swelled household balance sheets and left persons with less of a perceived need to save as much from their current income.

Retail Sales—Retail sales declined 0.8 percent in March following a revised 0.1 percentage point increase in February. Sales were 4.2 percent above their year-ago level. Both durable and nondurable goods sales increased 4.1 percent above their March 1985 levels. Part of the March decline was due to lower gasoline prices, which pushed gas station sales down 5.9 percent for the month, and to sluggish auto sales. March retail sales data indicated department and apparel stores registered strong gains, reflecting continued consumer confidence.

Trade Deficit—On a goods and services basis the trade deficit in the first quarter of 1986 was $95 billion, significantly below the $113 billion reported in the fourth quarter of 1985. The $18 billion drop in the trade deficit in the fourth quarter had a significantly positive effect on domestic production. The most encouraging news was that most of the decline was the result of increased exports, indicating that the decline in the value of the dollar is finally beginning to help U.S. firms export their products abroad.

What's Ahead—The composite index of leading indicators, designed to predict future movements in aggregate economic activity, jumped 0.7 percent in February. The January figure was revised to show that the index was unchanged from December. The contributors to the February increase in the leading indicators were contracts and orders for plant and equipment, stock prices, money supply, net business formations and slower deliveries by vendors, indicating a backlog of orders.

WHERE DOES THE FEDERAL DOLLAR GO?

The Department of Commerce recently reported that a total of $788.5 billion in federal money was spent by states and territories during 1985. The report reveals that $349.0 billion was spent in direct payments to individuals, such as Social Security, Medicare, and food stamps; $194.1 billion in procurement contracts for the Defense Department and other agencies; $115.5 billion for federal employee salaries, wages and benefits; $105.5 billion in grants to state and local governments; and $24.5 billion in other expenditures such as research grants and agricultural subsidies.

The per capita federal expenditure for the country as a

whole was $3,253. Federal expenditures by state ranged from a low of $2,399 to a high of $4,858. Per capita spending was highest in the following seven states: Alaska, Maryland, Virginia, New Mexico, Missouri, Hawaii and Connecticut.

GROWTH IN REAL GNP

The Federal Reserve Bank of St. Louis recently reported that a reduction in the negative impact of inventory investment (GNP minus real final sales), along with a slight increase in real final sales contributed to the acceleration of real GNP during the second half of 1985. The Fed states that increases in federal purchases of goods and services as well as residential fixed investment contributed towards the growth in real final sales (see table). However, both federal purchases and inventory investment were distorted by relatively large purchases by the Commodity Credit Corporation (CCC). Yet, excluding CCC purchases, federal purchases increased at a much smaller 7.2 percent rate in the second half of 1985 and inventory investment was positive. As the table shows, personal consumption expenditures, nonresidential fixed investment, and the growth of imports pulled final sales down during the second half of 1985.

REAL GNP AND SELECTED COMPONENTS
(compounded annual rates of change)

	II/1985 to IV/1985	II/1984 to II/1985	IV/1982 to II/1984
GNP	2.7%	1.9%	6.9%
Final sales	3.6	3.4	4.3
Personal consumption expenditures	2.2	2.7	5.2
Residential fixed investment	8.5	−0.2	29.2
Nonresidential fixed investment	6.3	10.3	13.6
Government purchases of goods and services	12.5	3.3	1.7
Federal	26.2	3.8	1.2
State and local	2.2	2.9	2.1
Net exports	–	–	–
Exports	1.2	−2.3	6.0
Imports	1.9	0.5	25.7

Source: Federal Reserve Bank of St. Louis

SALES AND INCOME TAXES DOMINATE TOTAL STATE TAX REVENUE

General sales and income taxes account for 70 cents of every tax dollar collected by state governments, the Commerce Department's Bureau of the Census reported recently.

Out of the $214.9 billion collected in state taxes during fiscal year 1985, $150.5 billion came from general sales, personal income, or corporate income taxes. Twenty years ago, taxes generated from these areas accounted for only 47 cents of the tax dollar. The proportion of taxes generated by sales taxes on items such as motor fuel, alcohol, and tobacco dropped significantly, from nearly one-third of the state tax total in 1965 to 16.6 percent in 1985.

DEPARTMENT OF LABOR REPORTS EMPLOYMENT AND EARNINGS CHARACTERISTICS OF FAMILIES

The U.S. Department of Labor's Bureau of Labor Statistics reported that nearly 60 percent of mothers in families with children under 18 were employed during the fourth quarter of 1985. While the total number of families with school or preschool children rose by 460,000 over the year, the number with employed mothers increased by 765,000 to 18.2 million.

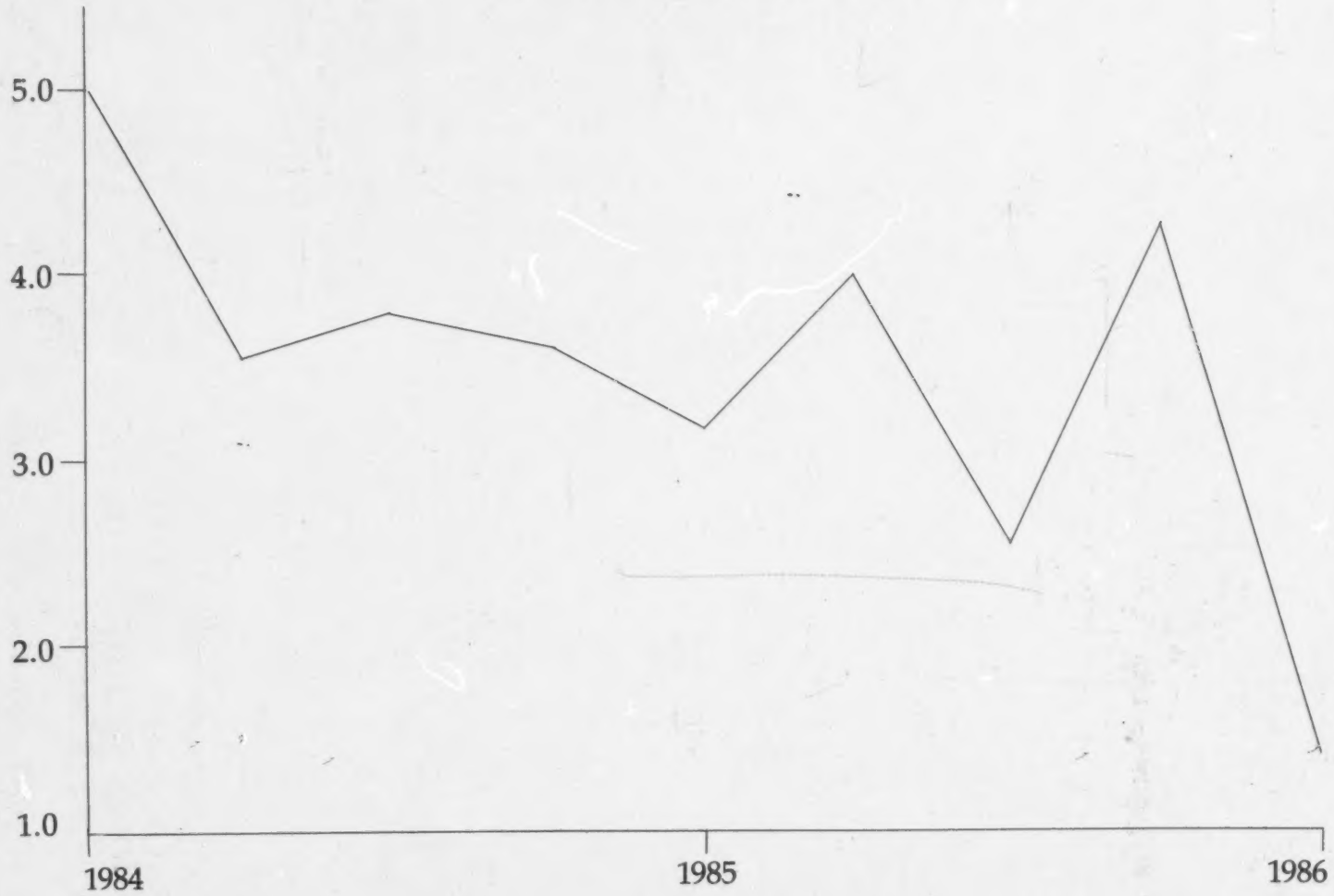
Other fourth-quarter highlights included the following: The total number of families with employed members grew by nearly 600,000 over the year to 50.8 million – 81 percent of all families. The number of married-couple families with one employed member increased by 300,000 from a year earlier to 42.1 million. The number of families with unemployed members was virtually unchanged over the year at 5.9 million. Nearly 80 percent of the married-couple families with unemployment also contained an employed member.

COMMERCE DEPARTMENT REPORTS BREAKDOWN OF MANUFACTURING JOBS

During 1983, one out of nine manufacturing jobs was related to the export of manufactured goods, according to the Department of Commerce in its *Annual Survey of Manufactures*. The total number of export-related jobs, 3.9 million, represented 3.7 percent of civilian employment in 1983. The report states that about 2 million export-related jobs were in manufacturing industries, which included 1.1 million in manufacturing plants producing finished goods for direct export, and 900,000 jobs were in affiliated plants and administrative offices furnishing materials and services to exporting plants.

Marked Deceleration in Inflation

(Percent Change)*



*Quarterly percentage change in the consumer price index at a seasonally adjusted annual rate.